No. 77-995

In the Supreme Court of the United States

OCTOBER TERM, 1977

HARRY GORDON and GERALDINE GORDON, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
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The question presented in this federal income tax case is whether the Commissioner's determination that petitioner failed to report income from wagering entitled petitioner to accrue and deduct the wagering excise tax with respect to such wagering income.

Petitioner Harry Gordon[1] was a member of a legal bookmaking partnership, the Derby Turf Club in Las Vegas, Nevada (Pet. App. C, p. 53). On audit, the Commissioner of Internal Revenue determined that in 1967 Derby accepted wagers substantially in excess of the amount it reported for either income or wagering excise tax purposes.[2] These additional wagers resulted in an

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[1]Geraldine Gordon is a party solely because she filed a joint income tax return with Harry Gordon for 1967, the year in issue (Pet. App. A, p. A-1).

[2]Section 4401 of the Internal Revenue Code of 1954 (26 U.S.C.) imposed a ten percent excise tax on wagers.

increase in petitioner's share of the profits from Derby and a deficiency in his 1967 income tax liability (Pet. App. A, p. A-2). Both the Tax Court and the court of appeals upheld the Commissioner's determination of unreported wagers in part (Pet. App. A, pp. A-2 to A-4). Petitioner argued alternatively that if the determination of unreported wagers were upheld, he should be allowed to accrue and deduct, in 1967, his aliquot share of Derby's wagering excise tax liability with respect to the unreported wagers. The Tax Court permitted the deduction for unpaid wagering excise taxes (Pet. App. C, pp. 77-78).

The court of appeals reversed (Pet. App. A, pp. A-4 to A-5). As it observed, "[s]ince the amount of petitioner's liability for the excise tax was not finally accrued until our decision passed on the tax court's computation of the Derby's unreported gross wagers, the deduction for the excise taxes cannot be permitted to offset the unreported 1967 income" (Pet. App. A, p. A-5).

1. It is an established rule of accrual tax accounting that, where a liability for a deductible tax is contested, then the deduction for such tax is accruable, "only for the taxable year in which * * * liability for the tax * * * [is] finally adjudicated." *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516, 519. Accord: *Security Mills Co.* v. *Commissioner*, 321 U.S. 281, 284; Treasury Regulations on Income Tax, Section 1.461-1(a)(3) (26 C.F.R.).

The decision of the court of appeals is in accord with the uniform line of decisions that a taxpayer "* * * using an accrual method of accounting, * * * is not entitled to accrue * * * [taxes] on additional income * * * added by the Commissioner and contested by the taxpayer." *Chesbro* v. *Commissioner*, 21 T.C. 123, 130, affirmed *per curiam*, 225 F. 2d 674 (C.A. 2), certiorari denied, 350 U.S. 995. Accord: *Curran Realty Co.* v. *Commissioner*, 15 T.C. 341, 344; *Concord Lumber Co.* v. *Commissioner*, 18 T.C. 843, 848-489; and *Anchor Cleaning Service, Inc.* v. *Commissioner*, 22 T.C. 1029, 1035. The rationale of these

decisions is that when a taxpayer denies receiving income he also denies liability for all taxes on, or taxes measured by, that income. As a result, his contest of the tax liability postpones its final adjudication and deductibility under the rule of *Dixie Pine Co.* and *Security Mills Co.*

2. Contrary to petitioner's argument (Pet. 5-7), the decision below does not conflict with *Hollingsworth* v. *United States*, Nos. 115-72, 283-74, decided December 14, 1977 (Ct. Cl.) (41 A.F.T.R. 2d 78-384). There, the Court of Claims held that the filing of a false federal or state income tax return omitting income from several transactions did not prevent the taxpayer from accruing and deducting for federal income tax purposes any subsequently determined deficiencies in state taxes. Here, on the other hand, the court of appeals held that petitioner's continuing litigation with respect to the amount of unreported wagering income prevented the accrual of the wagering excise taxes associated with that income. Indeed, while the Court of Claims in *Hollingsworth* spoke approvingly of the Tax Court's opinion in this case upholding petitioner's claim to accrual, it noted that the issues in the two cases were different (see 41 A.F.T.R. 2d at 78-389 n. 13).

3. Finally, petitioner argues (Pet. 10) that the standard for accrual of the wagering income and wagering tax expense deduction is the same, so that if he is to be taxed on the additional wagers in 1967, he should be allowed to accrue the deductions. But it is undisputed that the wagering income had been paid to Derby and was earned in 1967. It was therefore accruable in 1967 since the amount was determinable and its receipt was not subject to any contingencies. Treasury Regulations on Income Tax, Section 1.451-1(a). However, the wagering excise taxes were not paid in 1967 and petitioner continued to contest them by litigating the income tax deficiencies based upon

unreported income from wagering. As unpaid and contested liabilities, they were not accruable in 1967, even though they related to events in 1967. *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516; *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; Treasury Regulations, Section 1.461-1(a)(3). If the wagering excise taxes had been paid in 1967, they would have been accruable in 1967, despite the fact that petitioner contested his liability for those taxes. See Section 461(f) of the Code.[3] Since petitioner did not pay those taxes in 1967, that statute is inapplicable.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
Solicitor General.

MARCH 1978.

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[3]SECTION 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

* * * * *

(f) [as added by Section 223(a), Revenue Act of 1964, 78 Stat. 19, 76] *Contested Liabilities.*—If.—

(1) the taxpayer contests an asserted liability,

(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

(3) the contest with respect to the asserted liability exists after the time of the transfer, and

(4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxible year),

then the deduction shall be allowed for the taxable year of the transfer. This subsection shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of any foreign country or possession of the United States.

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